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Office of Near Eastern and South Asian Analysis
Directorate of Intelligence

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NOTE FOR: James B. Kelly
Deputy Assistant Secretary for Africa,
the Near East and South Asia
Department of Commerce

Attached is the paper on the Indian economy that you requested for Secretary Baldrige's briefing book. If you have any questions or if there is anything else we can do for you in preparation for the Secretary's trip to India, please call

[redacted] Chief, Subcontinent Branch 25X1

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10 April 1985

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INDIAN ECONOMY -- STRUCTURE AND TRENDS

Sluggish Growth

India's gross national product has increased on average 3.8 percent annually since the mid-1960s. With population growing about 2.1 percent annually, per capita GNP has grown only slowly, and at $240 remains one of the lowest in the world. Moreover, the economy is still vulnerable to wide weather-related swings in agricultural and industrial output. 25X1

Despite the vagaries of weather, agriculture -- which accounts for one-third of GNP and employs more than two-thirds of the labor force -- has shown impressive gains. Modern farming practices and expanded irrigation have generated the Green Revolution in foodgrain production while providing income for increased purchases of manufactured goods. 25X1

Another success story has been crude oil production which has expanded rapidly since 1982 with the exploitation of offshore fields. The resulting reduction in India's net oil import bill brought the total trade deficit down to $5 billion, the lowest since 1979, even though the non-petroleum trade deficit increased. 25X1

Manufacturing output has grown less than 5 percent a year during the past decade. Electric power shortages -- sometimes weather related -- are an important constraint on production. Much manufacturing capacity is underused, poorly maintained and obsolete, partly because government regulations have protected inefficient producers and prevented large private firms from expanding. Overstaffing and cumbersome bureaucratic procedures have handicapped many public sector corporations. 25X1

Economic Policy Tools

Since independence, Indian policymakers have tried to promote the often-conflicting objectives of economic growth, equity, and self-reliance through a pervasive government role. Although restrictions on the private sector have been eased since 1980, many direct controls on imports and on industrial location, production, and investment remain. Most banks have been nationalized and must direct a large share of their loans to priority sectors specified by the government. Government support through loans, share purchases, and underwriting finances as much as 40 percent of the cost of large private projects. Official financial institutions hold more than a fifth of the equity of several hundred private corporations but have only rarely intervened in their business decisions. 25X1

Other policy tools include public sector spending, which accounts for more than 45 percent of total investment, and tax and monetary policy. Meanwhile, central and state government institutions handle almost 60 percent of India's imports and dominate production in key industries such as petroleum, electricity and steel. 25X1

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Private Industry

The private sector is led by large industrial conglomerates. Many of them -- such as the Tata and Birla groups -- are still associated with their founding families, although shares are now widely owned. Western management techniques are spreading, but some of the most aggressive industrial houses are still run in an Indian style -- emphasis on constant growth and on cash generation rather than profits; the top family official exercises almost total authority by monitoring a cash flow budget. 25X1

Small factories and households are responsible for roughly 40 percent of Indian manufacturing. Government regulations reserve several hundred items for production exclusively by small-scale industries and provide them with tax and credit concessions. During the past decade, 'ancillaries' -- small units that produce parts for other manufacturers -- have been booming. 25X1

Government controls and high tax rates have generated a large 'black economy' -- unreported transactions that sustain production as well as luxury consumption. Rajiv Gandhi is campaigning against corruption, but also hopes to legitimize much of the ''black economy'' by reducing controls. 25X1

Business leaders have relatively easy access to economic policymakers through private contacts and meetings sponsored by business organizations such as the Federation of Indian Chambers of Commerce and Industry. They have had input on specific measures but have not, in general, had much influence on the government's overall economic strategy. 25X1

More than 500 industrial establishments have research units, but on average they spend less than one percent of their sales proceeds on research, compared with 3.7 percent for US companies. The rapidly growing electronics, telecommunications and motor vehicle industries still rely heavily on imported technologies and on imports of key components. The number of cooperation agreements approved between Indian and foreign business firms has grown since the easing of controls in 1980 to 740 last year and will probably increase in response to Rajiv Gandhi's push for assimilation of advanced technology. Most research is conducted by the government and is devoted heavily to agriculture, defense, and atomic energy. 25X1

Balance-of-Payments

International transactions are a relatively small but critical part of the vast Indian economy. India's foreign trade policy emphasizes export promotion as well as import substitution. 25X1

Imports -- about 10 percent of GNP -- provide an essential supplement to domestic production of petroleum, fertilizer, edible oils and, in some years, foodgrains. The volume of general imports, including capital goods, has grown rapidly since controls were first eased in the late 1970s. Purchases of consumer goods other than food are negligible. No single country supplies more than 15 percent of non-military imports; the United States, the USSR, and Middle Eastern oil exporters are major suppliers. New Delhi's defense effort relies heavily on Soviet equipment, in part because of the favorable credit terms. [redacted] 25X1

Merchandise exports contribute only six percent of India's GNP. Agricultural products and raw materials still account for about 30 percent of total exports, although New Delhi had some success in pushing sales of manufactured goods during the 1970s when Middle Eastern OPEC countries became important buyers. The volume of total exports stagnated in the early 1980s partly because Indian manufacturers found the domestic market more profitable. The US and the USSR are India's principal markets, but other developing countries buy a third of India's exports. [redacted] 25X1

International financial reserves of $6 billion are now adequate -- equivalent to 4 to 5 months of merchandise imports -- largely because India borrowed $4.5 billion from the International Monetary Fund during the past five years. Concessional aid receipts have levelled off but still provide more than $2 billion a year, and New Delhi has turned increasingly to foreign borrowing on commercial terms. Receipts from direct foreign investment remain negligible. Transfers and bank deposits from Indians resident in other countries help to finance the trade deficit. [redacted] 25X1

Prospects for Growth

The Indian economy has several important assets. Although 65 percent of the adult population is illiterate, more than 30 million workers have completed at least secondary education. The manufacturing sector -- one of the twenty largest in the world -- is highly diversified, capable of producing all but the most technically sophisticated goods, and will have new opportunities following liberalization of controls on private production and investment. In addition, domestic savings -- 23 percent of GNP -- are high for a poor country. [redacted] 25X1

At the same time, several factors point toward increasing balance-of-payments strains within the next two years that could jeopardize India's ability to become more productive and efficient through liberalized import restrictions. Scheduled payments to the IMF and military suppliers will mount sharply, and prospects for a reduction in the net petroleum import bill, rapid export growth, or increased foreign aid are poor. Expansion of the domestic economy would require an even faster growth in the volume of imported capital goods. Wary of falling into a debt trap, New Delhi will probably try to avoid a substantial increase in commercial borrowing to finance imports. [redacted] 25X1

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SUBJECT: Indian Economy -- Structure and Trends [redacted] 25X1

Distribution:
Original & 1 - James B. Kelly
Deputy Assistant Secretary for Africa,
the Near East and South Asia
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